Open Account Terms Can Increase Your Sales in Global Markets

By Dennis R. Chrisbaum

The world has become an increasingly competitive marketplace. A flood of products from China, technical services from India, competitive financing packages from Asia, and government support for exporters from several countries. How can an American exporter win? An often overlooked option is for U.S. exporters to offer more competitive, open account payment terms, with the additional risk mitigated through credit risk insurance.

Traditionally, there are four main ways to get paid for export sales. From the most conservative to the most risky for the exporter, they are:

- Cash-in-advance
- Letter-of-credit
- Documentary collections
- Open account terms.

Cash-in-advance is pretty straight forward: You are telling your buyer to send you the money, and you will send the goods—safe for you, but a big risk for your buyer! (When you receive the money, you have both the cash and the goods, and your buyer has neither!) So, some buyers may be rather hesitant to jump at this payment option. The risk to you the exporter, however, is basically zero **if** you have the products in inventory and ship them after receiving the funds, or **if** you only begin producing the order **AFTER** you receive the funds, using your buyer's money to finance your working capital needs for the production cycle.

A documentary letter of credit is relatively safe, because it will ensure that money has been deposited in your buyer's bank and, if you can document that you have met the terms and condition of the letter of credit, you will be paid. This instrument has been very effective in reducing the perceived risks between buyers and sellers who might not know one another very well, because they trust their respective banks: a) to not release the funds until there is documentary evidence that the order has been shipped (from the buyer's perspective), and b) to be paid shortly after goods have been shipped (from the seller's perspective).

Documentary collections use the banking system to ensure that goods are paid for (cash again documents) or a promise is made to pay for them (documents against acceptance) before the goods are received. The buyer can only receive the transportation and title documents when one of those conditions is met, helping to assure the exporter that he will be paid before the goods are released. While the banking system does not have enforcement powers (or any responsibility for ensuring payment), this method works well for known, reliable buyers using a developed, transparent banking system, typically in Western industrialized countries.

Open account terms generally are viewed as the most risky method of the payment for international transactions. Do you really know the credit worthiness of your buyer in Brazil or South Korea? Well, you can (and should) conduct standard due diligence by ordering credit reports on overseas buyers, just as you do for domestic buyers. Several companies sell these reports, such as Graydon America, Owens Online, Credit Risk Monitor, and Dun &

Bradstreet International. But, once you qualify your buyer for open account terms, commercial and political risks still remain. While commercial risk exists for any buyer, there might well be additional risks related to your buyer's country that could impact your customer's ability to pay. These political risks will vary widely by country and over time, but they will exist, even when selling to Canada. When you cross the border, your exposure no longer is in the United States.

Fortunately, there is a well-established way to mitigate these commercial and political risks. Called *credit insurance*, it is specialized insurance coverage with all the standard insurance features: a policy, a premium, a deductible and a claims process in case of loss. You can get a free quote from special insurance brokers and will not incur any costs until you commit to a policy. Insuring overseas accounts receivable offers U.S. exporters several advantages:

1. You can sleep at night, knowing if there is a default on your foreign accounts receivable, the insurer typically will pay 90-95% of the invoiced amount.

2. You will be able to secure additional orders—and, generally larger orders—than you would by only offering cash-in-advance or letter-of-credit payment options, because your buyers will not have to come up with the money up front (cash-in-advance) or prior to receiving the goods (letter-of-credit).

3. You will be able to borrow against the insured, foreign accounts receivables—unlike uninsured foreign accounts receivables, which lenders typically kick out of any borrowing base. Credit insurance will enhance your ability to secure working capital to support your transactions or ongoing business. Importantly, the U.S. Small Business Administration's Export Working Capital guaranty loan program can be used along with credit insurance to establish a revolving line of credit (up to $2 million) to fund your export transactions.

What is the cost? For a small business with less than $5 million in open account sales to foreign buyers over the past two years, the cost is only 65 cents per $100, or .65%, of the invoiced amount under the Eximbank small business policy—a pretty small mark-up to secure the three benefits listed above. And, typically this cost can be passed through to the buyer, who would much prefer having open account terms and avoiding the additional costs related to opening a letter-of-credit or paying cash in advance. For companies with more than $2 million in foreign, open account sales annually, an even less expensive credit insurance policy probably could be obtained from one of the large private insurers such as Coface, FCIA Management, Euler Hermes, or AIG.

So, as you think about how to expand your export business in the coming months, consider offering open account terms to your buyers—which you can do prudently by securing credit insurance on those sales. In a world that is becoming more competitive every day, being able to offer open account terms on an insured basis could very well make the difference in your international sales success.

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